Banks' net-zero pledges could add up; Shareholder activism is harder in Canada, but customers have power

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Body

For the longest time, the banking industry managed to position itself as an industry that has nothing to do with the climate crisis. Banks have nurtured the narrative that as an industry that provides services, their main role is to manage the financial risk involved in the loans they provide. At max, they should worry about recycling practices at their head office.

But in recent years, NGOs and other activists are putting the spotlight on the banks and exposing the key role they play in the fossil fuel life cycle.

In a recent report documenting banks' role in the climate crisis published by a coalition of environmental groups including Sierra Club and Rainforest Action Network, three of Canada's major banks (RBC, TD Bank and Scotiabank), were listed among the world's Top-10 largest lenders to oil and gas firms. New financial data from German non-profit Urgewald show similar evidence.

This changing climate has finally led banks to adopt climate-action plans which carry a "net-zero by 2050" commitment in the spirit of the Paris Agreement.

Financial giants such as Barclays, HSBC and JP Morgan were first to announce their pledges and, in November, TD, Canada's second largest bank, was the first of Canada's Big Five to make a similar net-zero commitment. There is little doubt that the other big banks will follow in coming weeks or months.

The pledges are important. It is exciting to hear banks including RBC and TD declaring that they won't finance any new oil and gas projects in the Arctic Circle. But TD admits that "the precise path to achieve the 2050 target remains unclear," which hurts the credibility of the pledge.

Moreover, the Paris Agreement indeed sets the year 2050 as the target year to become net-zero greenhouse gas emissions, but it also highlights the urgent need to reduce emissions by at least 50 per cent by 2030 compared with 1990 levels. So far, banks haven't said much about 2030 targets.

Laura Zizzo, co-founder and CEO of Manifest Climate, thinks the banks realize the transition is really happening and that they need to rethink age old truths in banking in light of climate change.

"I think the banks are being authentic when they say they are not sure exactly how to get to net-zero," she said in a Zoom interview.

"If a bank has a revolving facility with an energy company, it doesn't know what within that energy company is going to transitionary investments or continuing to exploit fossil fuel reserves," she said. "The banks need better data,

which is why the first iteration needs to be alignment with the guidelines of TCFD (Task Force on Climate-Related Financial Disclosures). But clearly, it doesn't make it less urgent."

So, with the clock ticking and the banks providing no credible, measurable, specific targets, all the while still generating billions of dollars in profit through loans to polluting industries, who among their stakeholders can push them to accelerate their transition to a low-carbon economy, and how exactly?

The first group that comes to mind is the banks' shareholders. Activism by institutional investors or other investors is standard practice nowadays.

BlackRock, the largest asset manager in the world, is a good example of a company leveraging its voting power into action. In its most recent letter to CEOs, BlackRock chief Larry Fink, was very specific in his expectations of CEOs to move faster towards net-zero. BlackRock holds about 6-8 per cent of every S&P 500 firm due to its massive index-funds business, so it has a say. It could also create coalitions with other institutional investors, as they jointly hold about 70 per cent of the shares in the largest banks in the U.S.

The ownership structure of Canadian banks is very different, however. Ownership is highly diffused, and there are no institutional investors with significant voting power. In fact, there is substantial cross-ownership in the Canadian banking industry. RBC, for example, holds about nine per cent of the shares of Bank of Montreal (mostly through its funds products). So the banks are somewhat protected against activism campaigns, but not completely.

A recent example for the power of shareholder activism is "Reenergize Exxon" launched by Engine No. 1, a campaign by an activist investor who owns less than $50 million in Exxon shares. Even with the support from CalSTRS (California State Teachers' Retirement System), they make up only about 0.2 per cent of Exxon's public holding. Nevertheless, they're pushing the oil giant to overhaul its board of directors by adding four new members who have the expertise to steer the company towards climate neutrality.

A second group of stakeholders that could put pressure on banks is the customers. They can simply vote with their feet and move their banking business to a climate friendly credit union such as Vancity or Groupe Desjardins.

Another stakeholder in the banks' landscape is the newly established Institute for Sustainable Finance, whose mission is "to align mainstream financial markets with Canada's transition to a prosperous sustainable economy."

But in a smart move on their part, the Big Five banks recently injected $5 million in donations to the institution, which unfortunately will limit the institute's independence and ability to criticize the banks.

What should stakeholders ultimately demand from the banks?

Topping that list should be a call for the banks to link executive pay with climate related goals. Such a link already exists in many other industries. It might come as a surprise, but the world's largest oil and gas firms have already or are in the process of implementing it. Mark Carney, the United Nations' special envoy on climate action and finance is also supportive of the idea.

If the banks' CEO pay continues to be a function mostly of their stock prices, why would they voluntarily take actions that might hurt them in the short term? Financing oil and gas is still a lucrative business for the banks.

Without such a link, and without specific targets that should be met year over year the banks' net-zero promises are nothing more than a polished PR campaign.

Zizzo acknowledges the role of investors but thinks that the penny would drop when the banks finally realize that the transition is essential for their good business. "It's still difficult for the banks to scarify some short-term profits for their stability and profitability in the medium and long term. And for that, aligning executive compensation with climate related targets is a great idea," she says.

As the march to net-zero continues for the big banks, stakeholders must increase their pressure by demanding that measurable, credible targets will be put in place and that the banks's heads will be incentivized to meet them.

As long as these are not in place, the whole "net-zero by 2050" campaign is simply cheap talk.

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